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C O N F I D E N T I A L SECTION 01 OF 02 HONG KONG 000113

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STATE FOR EAP/CM AND EEB/IFD

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TAGS: [EFIN](#) [ECON](#) [EINV](#) [HK](#) [CH](#) [RS](#)

SUBJECT: RUSAL IPO IN HONG KONG: ALL RISK, NO REWARD FOR
HKEX?

Classified By: E/P Chief Martin Murphy, Reason 1.4 b/d

11. (C) SUMMARY: Russian Aluminum company Rusal is set to be the first Russian company to list on the Hong Kong Stock Exchange (HKEx) when it completes its Initial Public Offering (IPO) on January 27. Rusal's questionable corporate governance, precarious debt profile, and its CEO's alleged ties to organized crime delayed HKEx approval for more than a year before a complex debt restructuring deal and appointment of two local independent directors facilitated HKEx approval.

HKEx is willing to accept the reputational risk of listing a company with Rusal's problems to help diversify its China-centric market. But Hong Kong's Securities and Futures Commission (SFC) has thrown cold water on HKEx's plan by restricting the IPO to institutional investors able to purchase at least HK\$1 million (US\$130,000) in shares and requiring trades in large board lots that will make the stock unavailable to many smaller investors. Retail investors are crying foul and HKEx fears its attempt to woo other Russian companies will be undercut by the SFC's attempts to protect small investors. END SUMMARY

HKEx Takes the Risk, Hopes for Rusal Rewards

12. (U) After several false starts and a complicated debt rescheduling, Russian aluminum giant Rusal appears set to issue shares in Hong Kong on January 27. Rusal would be the first Russian company to list in Asia and seeks to raise as much as US\$2.6 billion to pay down its US\$14.9 billion in debt. Since its establishment in 2000, the product of a merger of Sibirsky Aluminum (controlled by Oleg Deripaska) and the aluminum assets of Millhouse Capital (a Russian holding company controlled by Roman Abramovich), Rusal has borrowed heavily to acquire manufacturing and raw materials assets in Russia, Guinea, Guyana, Australia, and China. (Note: companies controlled by Deripaska purchased all of Millhouse Capital's stake by 2004, leaving Rusal under Deripaska's control). Rusal is reportedly now the world's largest aluminum producer, accounting for 12% of global aluminum output.

13. (U) HKEx and Hong Kong government officials have been seeking greater diversification of companies listed on the Hong Kong Stock Exchange for several years with limited success. Mainland China-related companies have come to dominate the HKEx, accounting for 40 percent of all listed companies, 58 percent of market capitalization and 72 percent of turnover in 2009. Less than ten percent of listed companies are from outside Mainland China or Hong Kong, with the largest share of those based in Taiwan. A handful of companies from Southeast Asia, the UK, the US and Canada, mostly with business interests in China, are also listed in Hong Kong. Hong Kong is eager to add a large international

company with a global business reach to its stock market.

¶4. (C) Rusal's listing application has been fraught with problems. The HKEx Listing Committee approval in December 2009 came after three previous applications were deferred due to questions about Rusal's corporate governance, Deripaska's alleged ties to Russian organized crime, and financial solvency. A complex deal to restructure US\$16.7 billion of debt to over 70 creditors and an agreement by Russian state-controlled bank Venesheconombank (VEB) to invest US\$600 million in Rusal and roll over a US\$4.5 billion loan due in late 2010 appear to have addressed HKEx concerns about Rusal's solvency for now. The December 2009 appointment of two well-known Hong Kong independent directors, Hong Kong Mercantile Exchange Chairman Barry Cheung Chun-yuen and former Secretary for Justice Elsie Leung Oi-sie, gave HKEx officials the additional comfort needed to approve the listing. Leung was a well-regarded Justice Secretary but has no previous business experience. Her appointment is widely viewed as an attempt to reassure HKEx officials and Hong Kong regulators that Rusal will abide by HKEx rules.

SFC's "Bizarre" Efforts to Protect Investors =====

¶5. (C) HKEx officials may be satisfied, but the Hong Kong Securities and Futures Commission (SFC) clearly has its doubts. The SFC has taken the unique step of restricting Rusal IPO subscriptions to institutional investors, requiring a minimum investment of HK\$ 1 million (US\$130,000), and will require Rusal shares to be traded in board lots of 200,000 shares, effectively shutting out most small retail investors

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in Hong Kong. The SFC's decision was criticized as "bizarre" by former HKEx Independent Director and noted gadfly David Webb, who noted that Rusal's lack of an offering to retail investors not only violated HKEx rules but, ironically, reduced protections for these investors. This is because, following the IPO, individuals could not be excluded from trading in Rusal shares, and those buyers on the secondary market would have no recourse to the courts in the event of misinformation in the prospectus.

¶6. (C) Webb criticized the SFC decision as inconsistent with previous rulings rejecting large board lots and noted that large board lots actually increase risk by making it more difficult for investors to diversify their equity holdings. Several commentators speculated that the SFC's ruling was heavily influenced by investor complaints about Lehman Minibonds but noted that the SFC's attempts to protect small investors were unlikely to prevent them from investing in Rusal stock once it began trading in the secondary market. Indeed, the restrictions were likely to result in more complaints if the share price increased in early trading, said former Legislative Councilor and political commentator Albert Chan.

HKEx Didn't Realize Biggest Risk was SFC =====

¶7. (C) The HKEx was disappointed with the SFC restrictions, said HKEx Executive Vice President Lawrence Fok. A successful Rusal launch was seen as a first step towards attracting additional listing business from outside greater China, a key part of Hong Kong's plan to compete with rival Shanghai. The review process was thorough and demanding, he said, pointing to Rusal's 1,100 page prospectus as proof. But Fok worried that Rusal's restricted listing would discourage other companies from listing in Hong Kong. Noting that Rusal Global Depository Receipts would begin trading on Euronext at the end of January, Fok dismissed suggestions that Rusal's listing would be profitable for the HKEx. Most of the Rusal trading was likely to take place on the Euronext platform, he said. Given the lengthy and expensive vetting process in this case, HKEx was unlikely to see any

significant financial benefits, but HKEx officials were hoping that the high profile listing would attract others to the Hong Kong exchange. The SFC's restrictions might encourage other Russian companies to look again at the London Stock Exchange, where they faced less scrutiny, grouched Fok.

18. (C) But others warn that HKEx is risking its good name by listing a company like Rusal. Raymond Chan, director of the Center for Corporate Governance and Financial Policy at Hong Kong Baptist University, told the press that Rusal's listing in Hong Kong could tar the exchange's reputation as a home for high-quality companies. Several Hong Kong-listed companies were the subject of governance and regulatory inquiries in 2009, including a firm that was suspended shortly after its IPO for misrepresenting the company's value. Chinese firms have been drawn to Hong Kong for overseas listing due to its less stringent disclosure and reporting requirements compared to other international exchanges, said Chan. That increased Hong Kong's attractiveness but also damaged its aspirations to be a world-class financial center.

Lining up to be Signing up
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19. (U) Despite the criticism and the potential risk, institutional investors, led by some of Hong Kong's wealthiest residents, have lined up to buy Rusal shares. According to the press, Paulson & Co., Nathaniel Rothschild, Malaysian billionaire Robert Kuok, and Li Ka-shing have signed up to purchase shares worth US\$20 million to US\$100 million each, and Rusal's IPO was fully subscribed just three days after being made available, suggesting many respected investors believed a big bet in Rusal was likely to pay off.

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